SUPREME COURT, U. S.

IN THE

Supreme Court of the United States

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October Term, 1971
No. 71-403

GOUGH INDUSTRIES, INC., Debtor,

Petitioner,

vs.

DON ROTHMAN (Successor to A. J. Bumb, deceased), Receiver, State Board of Equalization,

Respondents.

Response to Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

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Opinions Below.

The opinion of the Court of Appeals involved is set forth in the Appendix of the Petition.

Jurisdiction.

Judgment of the Court of Appeals for the Ninth Circuit was entered June 22, 1971 and no Petition for rehearing was filed. Jurisdiction of the Supreme Court is invoked by Petitioner pursuant to 11 U.S.C. §§47c and 716 and 28 U.S.C. §1254(1).

Questions Presented.

The questions set forth in the Petition are not satisfactory to Respondent because they are couched so as to assume many of the points ultimately to be decided.

Respondent submits the following to be objective statements of the two issues to be determined:

1. In a Chapter XI proceeding where a confirmed Plan of Arrangement has provided "payment shall be made to those creditors entitled to priority under §64 (a)(2), (4) and (5) of the Bankruptcy Act," who is responsible for the payment of post-petition interest and penalties on pre-filing taxes: the debtor or the creditors?

2. In a Chapter XI proceeding wherein a Plan of Arrangement has been confirmed, under the Sales and Use Tax law of the State of California, to whom does the credit for bad debt losses on pre-Chapter XI Accounts Receivable belong: the debtor or the creditors?

Statutes Involved.

Respondent supplements the Statutes appearing in the Petition as follows:

CALIFORNIA REVENUE AND TAXATION CODE §6901:

> "Certification of excess amount collected: Credit and refund: Amounts less than $100: Overpayment of use tax by purchaser. If the board determines that any amount, penalty, or interest has been paid more than once or has been erroneously or illegally collected or computed, the board shall set forth that fact in the records of the board and shall certify to the State Board of Control the amount collected in excess of the amount legally due and the person from whom it was collected or by whom paid. If approved by the State Board of Control the excess amount collected or paid shall be credited on any amounts then due and

payable from the person under this part, and the balance shall be refunded to the person, or his successors, administrators, or executors."

§6937:

"Judgment in action by or in name of assignee, etc. A judgment shall not be rendered in favor of the plaintiff in any action brought against the board to recover any amount paid when the action is brought by or in the name of an assignee of the person paying the amount or by any person other than the person who paid the amount."

Statement of Case.

Respondent accepts the "Statement of Case" set forth in the Petition as providing a brief outline of the essential background of this matter.

ARGUMENT FOR DENYING WRIT.

In summary, Respondent contends that there is no basis for granting the Writ sought because none of the customary considerations are presented. Respondent will argue in detail concerning the following matters: (1) This case, the representation of Petitioner to the contrary, does not present any true conflict in the decisions of the Courts of Appeal. (2) No questions of overriding importance are presented and this matter essentially turns upon its own specific facts. (3) Viewed as a totality, the decision of the Court of Appeals is the correct one.

I.

The Court Below Properly Determined That Petitioner Was Responsible for the Payment of Post-Petition Interest and Penalties on Pre-Chapter XI Taxes.

1. The Receiver Paid the State Board of Equalization Claim With Reasonable Promptness in Light of All the Facts.

The petition in this matter opens with an attack upon the determination originally made by the Referee in Bankruptcy and sustained at both the District Court and the Court of Appeals' level, embodied in Finding of Fact XIX.

> "The failure of the Receiver to earlier make payment to the Board in part was due to desire to require an allowance by the Board of the credit for bad debts and to verify the claim submitted by the Board. The Court finds that the delay in payment arose out of a business judgment reasonably exercised by the Receiver."

This constitutes a finding of fact based upon the evidence heard by the tryer of fact, which evidence is sufficient to support the Finding as has been found by

the Court below. No valid reason can be seen why this Court should intervene in reversing a Finding of Fact not clearly erroneous where no overriding questions of public policy or of the general good are presented.

In an effort to bolster its attack on the Finding, Petitioner has tried to manufacture a confusion between *Boteler v. Ingels*, 308 U.S. 57, 60 S.Ct. 29, 84 L.Ed. 78 (1939) and *Nicholas v. United States*, 384 U.S. 678, 86 S.Ct. 1674 (1966). An analysis of these two cases will indicate to any reasonable auditor that they are so far apart as to preclude any "substantial doubt" created one upon the other.

The *Boteler* case involved a Trustee who operated a bankrupt's business during the operation *and after bankruptcy* the Trustee operated motor vehicles on California Highways during the period from January 1 to February 27th. At that time, the statute in California required the purchase of a motor vehicle license on January 1st and made the license delinquent and subject to a 100% penalty after January 31st. The Trustee in *Boteler* did not buy the licenses and later contended that Bankruptcy Act §57j (11 U.S.C. 893) precluded the enforcement of the 100% penalty against the bankrupt estate. The Supreme Court determined that by Act of Congress, the Trustee who operates a business is subject to State taxes and that Bankruptcy Act §57j did not apply to taxes, including penalties and interest thereon, incurred by the Trustee after bankruptcy as a result of his operation.

The *Nicholas* case, relies upon the *Boteler* case and is consonant with it. In the *Nicholas* case, a Chapter XI proceeding had been commenced in Florida. The debtor remained in possession after commencement of the proceedings, operating a motel. During the operation,

the debtor in possession withheld income and social security taxes from the employees. Unable to perfect a Plan of Arrangement, the debtor was adjudicated a bankrupt and a Trustee appointed to take over the administration on September 19, 1958. On October 31, 1958, the withheld taxes were due. The Trustee did not pay the taxes, nor file any returns in connection therewith. Later, the Trustee resisted payment of interest or penalties on the taxes. The Court held that the Trustee was liable for interest to the date of adjudication but must bear penalties because the taxes arose after the filing of the Chapter XI. It should be noted in this connection that the taxes were incurred after the commencement of the proceedings by a debtor in possession who, by the terms of Bankruptcy Act §342 (11 U.S.C. §742), has "all the title and * * * all the powers of a Trustee appointed under this Act." One may search the *Nicholas* case in vain for any source of confusion or any doubt created by it of the principles set forth in *Boteler*. Nothing contained in *Boteler* or *Nicholas* is in conflict and nothing in the decisions below in any way indicates that the Court thought that they were; and why Receivers should need any "guidance" because of them is a mystery.

2. The Post-Petition Interest Was Properly Assessed Against the Rehabilitated Debtor Where the Taxes Had Been Paid in Full.

Here Petitioner attempts to argue for a conflict in the following cases: *In re Johnson Electrical Corporation,* (CCA 2d 1971) 442 F. 2d 281; and *In re Vaughan,* 292 F.Supp. 731 (E.D. Ky. 1968).

It may be flatly asserted that there are no conflicts between *Circuits* in this matter. The court below and the Court of Appeals for the Second Circuit in *In*

re Johnson Electrical Corporation are in complete agreement in their interpretation of the meaning of *Bruning v. United States*, 376 U.S. 358, 84 S.Ct. 906, 11 L.Ed. 772 (1964), holding that non-dischargeable tax claims give rise to non-dischargeable interest thereon even where the tax claim has been paid in full in the bankruptcy administration. The only "conflict" which exists is in an interpretation of the *Bruning* case by the District Court in *In re Vaughan*. The *Vaughan* case does not appear to have been the subject of an Appeal on its determination by the supervising Court of Appeals in Kentucky. Therefore, the only decisions at the Court of Appeals' level in interpreting *Bruning* are consonant and this Court's intervention is not required.

Petitioner next argues that a different factual conclusion should have been reached on the question of whether or not the Plan of Arrangement by its terms called for the payment in any case by the creditors of post-petition interest and penalties. The Referee had before him in making the Finding of Fact VIII the Terms of the First Amended Plan of Arrangement drafted by the debtor and the terms of the Order Confirming the Plan of Arrangement entered December 17, 1964. The main evidence, other than the written documents, is the testimony of the debtor's lawyer, who had drafted the Plan of Arrangement, and who in oral testimony attempted to assist the contention being made by his client that the Plan of Arrangement was intended to require payment of post-petition interest and penalties on taxes. The tryer of fact heard the witnesses and was entitled to believe or disbelieve, to discount or to weigh, the oral evidence. Having done so, under the well-established appellate rule, those factual determinations should not now be reversed by a hearing sought by this Writ.

II.

Under the Sales and Use Tax Law of the State of California, Credit for Bad Debt Losses on Pre-Chapter XI Accounts Receivable Is the Property of the Estate for the Benefit of the Creditors Thereof.

Petitioner argues at length that the bad debt credit arising in this matter is the property of the reconstituted debtor—and does not belong to the estate for the benefit of the creditors.

This same argument was rejected by the Court of Appeals and respondent submits that a proper result was there reached.

Since there are no cases counsel or any of the Courts have so far discovered on the point of the sales and use tax, all argument and decisions have analogized this matter to the much more common problem involving the treatment of Federal income tax carrybacks in bankruptcy proceedings.

In any such analysis, the starting point for everyone must be *Segal v. Rochelle* (1965) 382 U.S. 375, 86 S.Ct. 511, 15 L.Ed. 2d 428. This case arose from a Texas partnership in which both member partners were likewise bankrupt. In this year of bankruptcy, the partnership experienced large operational losses, but in the two prior years, the partners had paid income taxes on substantial profits. The Trustee filed the required claim to recover the loss carryback and it was paid to him, whereupon the partners sought to reclaim the sum on the grounds that it belonged to them and

not to the bankrupt estate. The Court began by noting the language of Bankruptcy Act §70a(5) [11 U.S.C. 110] which vests in the Trustee

> "property, including rights of action, which prior to the filing of the petition * * * he could by any means have transferred or which might have been levied upon or sold by judicial process against him or otherwise seized, impounded or sequestered * * *."

The Court then determined that the claim for loss carryback is "property," saying at pages 379 and 380 of 382 U.S.:

> "The main thrust of §70a(5) is to secure for creditors everything of value that the bankrupt may possess in alienable or leviable form when he files his petition. *To this end the term 'property' has been construed most generally and an interest is not outside its reach because it is novel or contingent or because enjoyment must be postponed.* [Citing cases] * * * Turning to the loss carryback refund claim in this case *we believe that it is sufficiently rooted in the pre-bankruptcy past* and is so little entangled with the bankrupt's ability to make an unencumbered fresh start that it should be regarded as 'property' under §70a(5)." (Emphasis supplied.)

Then the Supreme Court addresses itself to the question of transferability, rejecting the impact of 31 U.S.C. 203, which prohibits transfers of claims against the Federal Government absent certain conditions.

Finally, the Court concludes that under the law of the State of Texas, the right was a transferable one and, therefore, the property of the Trustee in bankruptcy.

A reading of the Court of Appeals' decision in this matter will indicate that it considered the situation here analogous to that of the *Segal* case: and for good reason. As in the *Segal* case, the claim here derived from the pre-bankruptcy activities of the debor which gave rise to the Accounts Receivable involved. These Accounts Receivable, in turn, produced an obligation for sales and use tax which formed, in part, the original claim of the California State Board of Equalization in the sum of $85,978.95. Those Accounts Receivable and the sales tax obligations derived therefrom are uncontestably the property and the obligation of the bankruptcy estate. This parallels the obligation in the *Segal* case to pay taxes.

After bankruptcy, it is discovered that approximately $600,000 of the Accounts Receivable are uncollectable and the "bad debt credit" results. It will be noted in parallel with the *Segal* case again that the bad debt credit is referable to an occurrence before the filing of the proceedings.

Practically, what Petitioner now contends for is a result where the creditors would pay the original tax claim, including the amount of the bad debt credit of $24,503.19. The debtor would then be enriched by obtaining the benefit of that overpayment for itself as a credit against any future sales tax obligations.

To reach this position, Petitioner attempts to distinguish Segal in two ways: (1) by contending that the claims are "unassignable" under the California law and

that the "transferability" which is a major basis of the *Segal* case is not present; (2) that this condition should be analogized to a loss carry-forward rather than the loss carryback as in the *Segal* case.

In support of its position that there can be no assignability of such a claim, Petitioner relied below and here upon California Revenue And Taxation Code §6937 (See the "Statutes Involved" section for text). That statute on its face does not forbid assignability, but it is obviously merely a rule of procedure appearing in Article 2 of the Code in the subsection "Suit For Refund". The section merely sets forth that any action commenced against the estate must be in the name of the original taxpayer; it says nothing whatsoever about the assignability *between the parties* which is what *Segal* is all about. Collier On Bankruptcy 14th Ed., Vol. 4a, pages 402 and 403 comments on this:

> "Clearly, therefore, tax refund claims based on the loss-carryback provisions of the Internal Revenue Code, are property of the taxpayer even though contingent in nature before the end of the taxable year. This much is a matter of federal law stemming from the construction of the word 'property' as it is used in the Bankruptcy Act. Whether or not such claims are also transferable by voluntary act depends on state law and not federal law, the federal Assignment of Claims Act to the contrary notwithstanding. So long as the state courts *would permit an assignment of this otherwise non-assignable claim by enforcing it in equity as between the immediate parties, the claim is transferable.* * * *. It may well be that in all states there would be enforcement in equity of such a claim; there does not seem to be any argument

> as to why the assignor should not be held to his contract, but that is a matter for the bankruptcy court to determine by reference to the applicable local authorites." (Emphasis supplied).

That the claim is assignable between the parties is implicitly recognized by California Revenue And Taxation Code §6901, (See "Statutes Involved" section for text), the last portion of which is as follows:

> "If approved by the State Board of Control the excess amount collected or paid shall be credited on any amounts then due and payable from the person under this part, and the balance shall be refunded to the person, or his *successors, administrators, or executors.*" (Emphasis supplied).

In its attempt to analogize this matter to a loss carry-forward rather than a loss carryback, Petitioner has not demonstrated or argued here or below why this should make a substantial difference and, indeed, at least Collier On Bankruptcy 14th Ed., Vol. 4a, page 404, casts doubt that the result would be different:

> "Using some of the language of the Supreme Court, it may be said that the prior losses sought to be carried forward are 'sufficiently rooted in the pre-bankruptcy past and so little entangled with the bankrupts' ability to make an unencumbered fresh start that [they] should be regarded as 'property' under §70a(5)'."

Conclusion.

For the foregoing reasons—that there is no conflict in the decisions and that the decision below is clearly correct—it is respectfully submitted that the Petition For Writ Of Certiorari should be denied.

Respectfully submitted,

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Don Rothman, Receiver.